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REVENUE BILL OF 1935

July 29 (calendar day, August 14), 1935.—Ordered to be printed

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Mr. Metcalf, from the Committee on Finance, submitted the following

MINORITY VIEWS

[To accompany H. R. 8974]

We are unable to agree with the views of the majority of the Committee on Finance. We object strenuously to every provision in the bill as it passed the House, to each amendment proposing the imposition of taxes recommended by the majority of this committee, and to the enactment of any bill at the present time.

SUMMARY OF OBJECTIONS

Before attempting a detailed discussion of our position, we summarize our objections as follows:

(1) The bill is not a revenue measure for the following reasons:

(*a*) The only argument advanced in support of the bill is that "the President wants it."

(*b*) The bill is avowedly based solely upon "share-the-wealth" and "social control" fantasies; and the raising of revenues, if any revenue will be raised, is admittedly incidental.

(*c*) The enactment of the bill is directly contrary to the President's recommendations in his annual budget; and no budget estimates have been submitted upon which a revenue measure may appropriately be based.

(*d*) There is a demand for speed—yet no revenues can conceivably result during the calendar year 1935; only in insignificant amounts, under the most optimistic estimates, during the fiscal year 1936; inconsequential revenues (accepting the estimates as accurate) will be produced in the fiscal year 1937; and the proposed taxes can become wholly effective, from a revenue point of view, only in the fiscal year 1938.

(2) The proposed bill violates every sound principle of taxation.

(3) The majority party, both in the House of Representatives and as represented on this committee, evidence an utter disregard for obvious inequities and patent absurdities.

SUBSTITUTE RECOMMENDATIONS

We submit the following recommendations:

(1) Adjourn Congress immediately.

(2) Leave business alone. Substantial progress toward industrial recovery and normal business activities and economic conditions is being made, notwithstanding constant, continuous hampering and interference resulting from the unsound and untested experiments imposed by the present administration. A removal of the obstacles and a cessation of the threats are all that is now necessary. Healthy business conditions will do more to restore revenues and relieve unemployment than all the fanciful theories advocated by the President and his advisers.

(3) Eliminate extravagance and waste in Government expenditures and let us have a Budget showing a sincere and sound program for restoring a balance between expenditures and receipts. Our present revenue laws, already imposing unconscionably high taxes, will in all likelihood produce sufficient revenues.

(4) If additional revenues are required, give adequate opportunity for studying the operation of the present laws, the distribution of existing tax burdens, the relation between taxpaying ability and the innumerable other measures exacting tremendous sums from our citizens, including particularly producers and consumers.

(5) If additional revenues are required, enact a comprehensive and sound revenue measure based upon the foregoing studies and surveys and upon actual facts.

THE TITLE OF THE BILL

The bill is entitled:

> A bill to provide revenue, equalize taxation, and for other purposes.

We believe that the following title would more adequately and accurately describe the measure:

> A bill to confiscate property; to discourage business and prevent its expansion; to destroy incentive and discriminate against ability, brain, ambition, and enterprise; to create greater inequalities in the inequitable distribution of existing tax burdens; to promote unemployment and to obstruct recovery; to jeopardize the financial position of the Government; and for other improper purposes.

A bill bearing the above-suggested title may quite properly originate, and may be expected to originate, in the White House. The constitutional provision that all bills for raising revenue must originate in the House of Representatives would have no application. Accordingly, the bill should state on its face confirmation of the fact that it originated in the White House, without the advice, consent, or approval of anyone familiar with the principles of taxation, and has been rubber-stamped by an unwilling but docile Democratic Party in Congress.

BUDGET ESTIMATES

A bill to raise revenue is invariably and necessarily based upon Budget estimates. These estimates show the anticipated revenues, the expected expenditures, and the amount of additional revenues probably necessary to bring about a balance. Even in the stress of the war period, there was no departure from this basic and common-

sense policy. Preceding the present bill and during the period of its consideration, however, we find no estimates, no suggested substitute principle upon which a revenue measure may be planned and based, and no attempted justification for embarking upon a "hit-or-miss" or perhaps a "hit-and-run" policy.

THE RAISING OF REVENUES

It would seem axiomatic that a revenue bill should produce revenues for the Government. However, no estimates were transmitted to the Congress in the President's message. Government experts subsequently estimated that the President's proposals would raise a maximum of $100,000,000. Certainly no one believes that this amount has any relation to the revenue requirements of the Government. Accepting as accurate the estimated $270,000,000 of additional revenues for the bill as it passed the House of Representatives, we find no attempt to justify the collection of this amount. To the contrary, it seems to be admitted that this amount is both insignificant and ineffective when viewed from the point of view of a proper budget. Again, even this estimated amount seems to be quite accidental. The House of Representatives did not set out to raise either this amount or any specified amount. Rather, they seemed to have approved certain proposed principles and then to have estimated the amount which might incidentally come into the Treasury.

It is estimated that the bill as reported by the Committee on Finance will increase existing revenues by $254,000,000 "for a full year of operation." We are not told the basis for these estimates. We do not know whether they assume a continuity of existing business conditions, a betterment of them, or a possible retrogression. Nor are we told when the increased revenues may be expected. Obviously, nothing is expected for either the calendar year 1935 or the fiscal year 1936. The proposals can produce no revenues until the fiscal year 1937; and certainly they cannot become fully effective until the fiscal year 1938, at least. We can conceive of no possible justification for the enactment of this bill at this time, under these circumstances.

THE DEMAND FOR SPEED

The insistence upon speed finds no support in the production of proposed revenues. As we have pointed out, not one single cent can come into the Treasury during the present calendar year. And very little will be received—again accepting the estimates as accurate—during the fiscal year 1936.

A thorough study of revenue requirements, of existing tax burdens, and of the effect of proposed new taxes has always preceded the preparation of our revenue measures. Exhaustive, reliable, and necessary studies and surveys of possible sources of revenues and of proposed expenditures should be available to the Congress. But an intelligent consideration will require time and thought.

The conclusion is both inescapable and indisputable. The President does not even trust the judgment of the responsible members of his own party if that judgment is founded upon intelligent and adequate consideration.

DISTRIBUTION OF TAX BURDENS

The committee first agreed to impose income taxes upon our large group of citizens earning small incomes in order to broaden substantially our existing income-tax base. We agree that this is the only effective means of obtaining substantially greater revenues from an income tax—assuming that our national income does not increase. This proposal has been opposed, however, upon the ground that the individuals falling within the suggested income brackets are already contributing, indirectly, more than their fair share to the cost of our Government.

We strongly advocate the imposition of income taxes in the light of, and commensurate with, other tax burdens. But we are here asked to "legislate in the dark." We prefer to impose taxes in accordance with facts. We suggest a thorough survey in order that those facts may be accurately ascertained and in order that our revenue laws may be framed wisely, intelligently, and fairly.

COMPARATIVE OUTLINE OF BILL

The bill as reported by this committee proposes the following:

(1) An increase in individual surtax rates on net incomes in excess of $1,000,000—as recommended by the President.

(2) A graduated tax on corporations, ranging from 12½ to 15½ percent—substantially as recommended by the President.

(3) The deduction of charitable contributions by corporations—notwithstanding the strenuous opposition of the President.

(4) A tax upon intercompany dividends—recommended by the President solely as an unsound protection against the imaginary evasion of the unsound graduated corporation tax, and quite unnecessary and unjustifiable even for the purposes for which intended.

(5) A proposed increase of 50 percent in the existing capital-stock tax—apparently in an attempt to make the bill look like a revenue bill. The President did not recommend the increase, and the Secretary of the Treasury refused to advise this committee as to the attitude of the administration.

(6) An excess-profits tax upon corporations, with rates as high as 12 percent. Again, the President recommended no such tax and, again, the Secretary of the Treasury refused to commit the administration.

(7) Increased estate taxes, in addition to the estate taxes imposed by the Revenue Act of 1926, beginning with estates of $10,000 and ranging upward to 70 percent upon estates in excess of $50,000,000—in lieu of the hybrid, ill-conceived, and impossible inheritance tax recommended by the President.

(8) Increased gift taxes, commensurate with increased estate taxes—in line with the policy advocated by the President.

Eliminating the provisions not recommended by the President, the committee bill is estimated to yield $104,000,000 for the first year of its effective operation—probably the fiscal year 1938.

THE PROPOSED SURTAXES

There were 46 individuals who reported net incomes in excess of $1,000,000 for 1933. The President has singled them out. It is possible that he had their names reported to him. It is probable

that he hopes that his proposed taxes, in 1936 and subsequent years, will hit a few of them who may have dared incur his personal displeasure.

The President and the Treasury justify the proposed taxes purely as methods for controlling the size of incomes for "social purposes." We believe that a most dangerous precedent is established when the taxing power is used for purposes other than the raising of revenue. Even those who might agree with the so-called "social purpose" advocated by the President may some day find themselves opposing the policies advocated by others, to be made effective through the use of the taxing power. They may even find themselves in disagreement with others who think that "bigness" does not begin at $1,000,000 but perchance begins at $10,000.

We strenuously oppose the introduction of political and demagogic policies into our tax structure.

THE GRADUATED TAX ON CORPORATIONS

We oppose the proposed graduated tax upon the incomes of corporations for the following reasons:

(1) It disregards ability to pay and it disregards benefits received.

(2) It disregards the amount of capital used in the production of the income, as well as the nature of that capital.

(3) It discriminates against soundly financed enterprises and in favor of those which are unsoundly financed.

(4) It disregards the number of stockholders in a corporation and their relative abilities to contribute to the support of the Government.

(5) It discriminates against the small investor in the large corporation and in favor of the large investor in the small corporation; and against all investments in large corporations in favor of investments in smaller corporations.

In the testimony before the Committee on Ways and Means, the following outstanding authorities upon taxation are quoted as opposed to a graduated tax upon corporate incomes: Dr. H. J. Millis, of the University of Chicago, formerly president of the American Economic Association; Prof. E. R. A. Seligman, a former president of the American Economic Association and of the National Tax Association; Prof. C. C. Blehn, of the University of California, a former president of the American Economic Association; Alfred E. Holcomb, former president of the National Tax Association; and Henry F. Long, commissioner of corporations and taxation of the State of Massachusetts, and president of the National Tax Association.

Senator William Gibbs McAdoo, when he was Secretary of the Treasury during the war, expressed the following views which are strikingly appropriate:

> Any graduated tax upon corporations is indefensible in theory, for corporations are only aggregations of individuals, and by such a tax the numerous small stockholders of a great corporation may be taxed at a higher rate than the very wealthy large stockholders of a relatively small corporation.

Although not quoted in the current hearings, we appropriately add the opposition to a graduated tax on corporations frequently expressed by the late Dr. Thomas S. Adams, recognized as the leading tax economist of the country for more than a quarter of a century, and who served for many years preceding his untimely death as special adviser to the Treasury and to the committees of Congress.

THE INCREASE IN CAPITAL-STOCK TAX

The bill as reported by the committee increases the existing capital-stock tax from $1 to $1.50 per $1,000—an increase of 50 percent. The highest capital-stock tax rate imposed by this Government, even under the exigencies of the war period, was $1 per $1,000. The present capital-stock tax (including the supplementary so-called "excess-profits tax") is yielding approximately $95,000,000 a year.

The capital-stock tax is payable whether or not the corporation is operating at a profit. It is capable of producing the present revenues without undue hardship. Any increase in the rates will accentuate the unfairness of the tax.

It is estimated that approximately $50,000,000 will be collected in additional revenues under the increased capital stock tax and the excess-profits tax rates. Assuming that the necessity for raising this revenue were clearly established at the present time, we question seriously the wisdom of attempting to obtain it in this manner.

We endorse unqualifiedly the provisions of the bill permitting a new declaration of value. We do not approve the proposed adjustments to this declaration of value for the second and each subsequent year. Assuming that the proposed adjustments themselves are logical and fair—and we regret that they are not—they are adjustments to a purely fictitious figure. The result must be arbitrary. We recommend annual declarations of value, for each year during which the capital-stock tax ramains in effect.

THE PROPOSED EXCESS-PROFITS TAX

A reasonable excess-profits tax, as a device to enforce the payment of a reasonable capital-stock tax, is effective and acceptable. The present bill, however, proposes to adopt an excess-profits tax as a direct revenue producer. The tax is to be imposed at 6 percent if a corporation's net income exceeds 10 percent of its adjusted declared value; and at 12 percent upon so much of its net income as exceeds 15 percent of its adjusted declared value.

We agree with the opinions of substantially everyone who has considered an excess-profits tax—including Senator McAdoo, Senator Glass, and Secretary Houston, during their terms as Secretaries of the Treasury. We also agree with the views expressed by Treasury representatives during the hearings upon the current bill that an excess-profits tax necessarily discriminates against small corporations with fluctuating incomes and in favor of larger corporations with more stable incomes.

Under the bill as reported by the committee, a corporation with fluctuating income will pay an extraordinary high tax in the years of success and obtain no offsetting advantages as a result of losses or low incomes in other years. The committee bill even proposes to impose an excess-profits tax upon the entire income of a corporation which has struggled for years with losses, as a result of which its adjusted declared value is reduced, for example, to zero—and then subsequently fights its way into the production of income. If the committee or the Congress would care to give reasonable consideration to the proposed adjustments—which are identical with the provisions in the 1934 act, and their effect consequently should be

known—they would ascertain that the adjustments accomplish precisely the opposite effect usually sought in an excess-profits tax: The tax is reduced annually as incomes of previous years increase the "adjusted declared value"; while the tax is increased excessively and unreasonably upon those corporations which, for a period of time, operate at a loss. Again, we recommend an annual declaration of value as a basis for the excess-profits tax.

We also urge the adoption of our former net loss provisions, for both income- and excess-profits-tax purposes. The proposed excess-profits tax merely emphasizes the unfairness of using an arbitrary period of 1 year for measuring capacity to pay. England permits the carrying forward of losses for 6 years. We suggest the carrying forward of losses for 2 years, upon the same basis as existed under our revenue laws from 1918–32.

DEDUCTION OF CHARITABLE CONTRIBUTIONS

We commend those who assisted, over the strenuous opposition of the President, in the adoption of the amendment permitting the deduction by corporations, subject to reasonable limitations, of contributions for charitable purposes.

In considering the policy of the pending measure, it is also appropriate to point out in this connection that corporations engaged in manufacturing, in addition to their charitable contributions, have, during the period of depression, maintained a pay roll in excess of $5,000,000,000 more than was required in the needs of the business. Doubtless other corporations have similarly contributed a correspondingly huge amount to their employees in order to ease the terrific hardships of the depression. The total far exceeds the stupendous, unprecedented appropriations available for uncontrolled use by the President. The policies already adopted or advocated or threatened by the administration, including those embodied in the present bill, are obviously intended to prevent the accumulation of adequate resources with which to meet possible future contingencies. Can it be that the administration visions, in the return of healthy and normal business conditions, a repeal of the dictatorial powers granted to him and a threat to his individual control of unprecedented sums of money?

THE TAX UPON INTERCOMPANY DIVIDENDS

The bill as reported by the committee proposes to tax, at income- and excess-profits tax rates, 15 percent of the dividends received from other corporations, notwithstanding the fact that the funds used to pay the dividends have already been taxed.

There is no justification for such a tax. The only justification suggested is contained in the President's recommendations—namely, that such a tax is necessary to prevent evasion of the graduated tax on corporate incomes. In our opinion, the unsoundness of a corporate dividend tax merely accentuates the unsoundness of the graduated corporate income tax. An admittedly unsound provision is recommended to prevent the evasion of an admittedly unsound tax.

A corporation is merely a group of individuals. The income of a corporation is in effect the income of the group of individuals owning it. Were it not for constitutional provisions and for administrative

difficulties in collection, we should abandon a tax upon corporate incomes and tax, in lieu thereof, the individual stockholders upon their proportionate share of the corporation's income, whether or not distributed. Neither of these justifications of the present corporate tax will justify the duplicate, triplicate, and quadruplicate taxation of a stockholder's income prior to its distribution to him, necessarily resulting from the proposed tax upon corporate dividends. The Treasury frankly admits that under this provision the same income may be taxed 10 or 12 times.

The inadequacy and unsoundness of the multiple taxation upon corporate earnings used to pay dividends has been recognized by the Congress for almost 20 years. The principle embodied in substantially all of our revenue laws should not now be abandoned.

Furthermore, even the necessity advanced by the President for the proposed tax is unreal and nonexistent. Corporate enterprises cannot evade a graduated tax "through the device of numerous subsidiaries or affiliates." Business necessity and convenience, financial requirements, existing corporate obligations, and existing corporate organizations will effectually prevent the formation of subsidiaries and the division of income among them. These considerations far outweigh the slight possible savings in the graduated tax.

In addition, we point out that the committee fails to adopt the President's recommendation—obviously a sound and necessary one if his proposed dividend tax is to be enacted—that—

> Bona fide investment trusts that submit to public regulation and perform the function of permitting small investors to obtain the benefit of diversification of risk may well be exempted from this tax.

THE INCREASE IN ESTATE-TAX RATES

The President recommended an inheritance tax, to be imposed on top of our existing two estate taxes—and, of course, in addition to the estate and inheritance taxes of the various States. The inheritance tax contained in the bill as it passed the House of Representatives, it is conceded, will result in confiscation—in many instances more than 100 percent of the estate will be claimed by the Federal Government—and this must be the result desired by the President.

However, it is now generally admitted that the proposed inheritance tax as passed by the House must be abandoned. It required an hour for one witness before our committee merely to point out a few of the innumerable incongruities, inconsistencies, impossibilities, omissions, and monstrosities of the inheritance-tax provisions.

We suggest that the effect upon business, upon possible expansion and new enterprise, upon the production of wealth, and upon unemployment, are more vital considerations than the so-called "social purposes" supposed to be produced.

DEDUCTION FOR SHRINKAGE IN VALUE OF ESTATES

Section 202 of the bill as reported by the committee adopts the salutary principle that a deduction should be allowed in computing estate-tax liabilities for the shrinkage in value of the assets of the estate after the death of the decedent—usually an unavoidable and serious loss.

The committee, however, proposes to allow the deduction only for depreciation in assets during the first year following the death of the decedent. We believe this period should be extended to at least 3 years, and we were of the opinion that the Treasury approved this extension.

We also point out that this provision is to apply only to the estates of decedents who die after the enactment of the pending bill. We see no necessity for so limiting its application. As a practical matter, we recognize that the unlimited retroactive application of the provision is impossible. Accordingly, we recommend that the provision apply to the estates of decedents who have died since January 1, 1932. We see no conceivable justification for denying the benefits of this provision, for example, to estates which are bearing the extraordinarily high estate tax liabilities imposed by the Revenue Acts of 1932 and 1934.

DECLARATORY JUDGMENTS

On June 14, 1934, the Federal declaratory judgment law was enacted. Section 405 of the bill as reported by the committee proposes to prevent the application of the declaratory judgment law to Federal taxes.

Income- and estate-tax liabilities may now be determined, prior to the payment of any asserted deficiency, by the Board of Tax Appeals, an impartial tribunal composed primarily of experts, which for many years has heard and decided controversies between the Government and taxpayers upon the merits and judicially.

However, no similar method is available for determining additional liabilities for miscellaneous internal-revenue taxes proposed by the Bureau of Internal Revenue—unless it is the declaratory judgment law. A few courts have decided, and, we think properly, that the declaratory judgment law permits a determination of liabilities for these taxes. We believe that any doubt should be removed and that the declaratory judgment law should be specifically amended to make it applicable to all taxes not within the jurisdiction of the Board of Tax Appeals. As an alternative, we recommend that the Board of Tax Appeals be given jurisdiction to determine liabilities for all miscellaneous internal-revenue taxes prior to payment of asserted additional taxes.

Jesse H. Metcalf.
Daniel O. Hastings.

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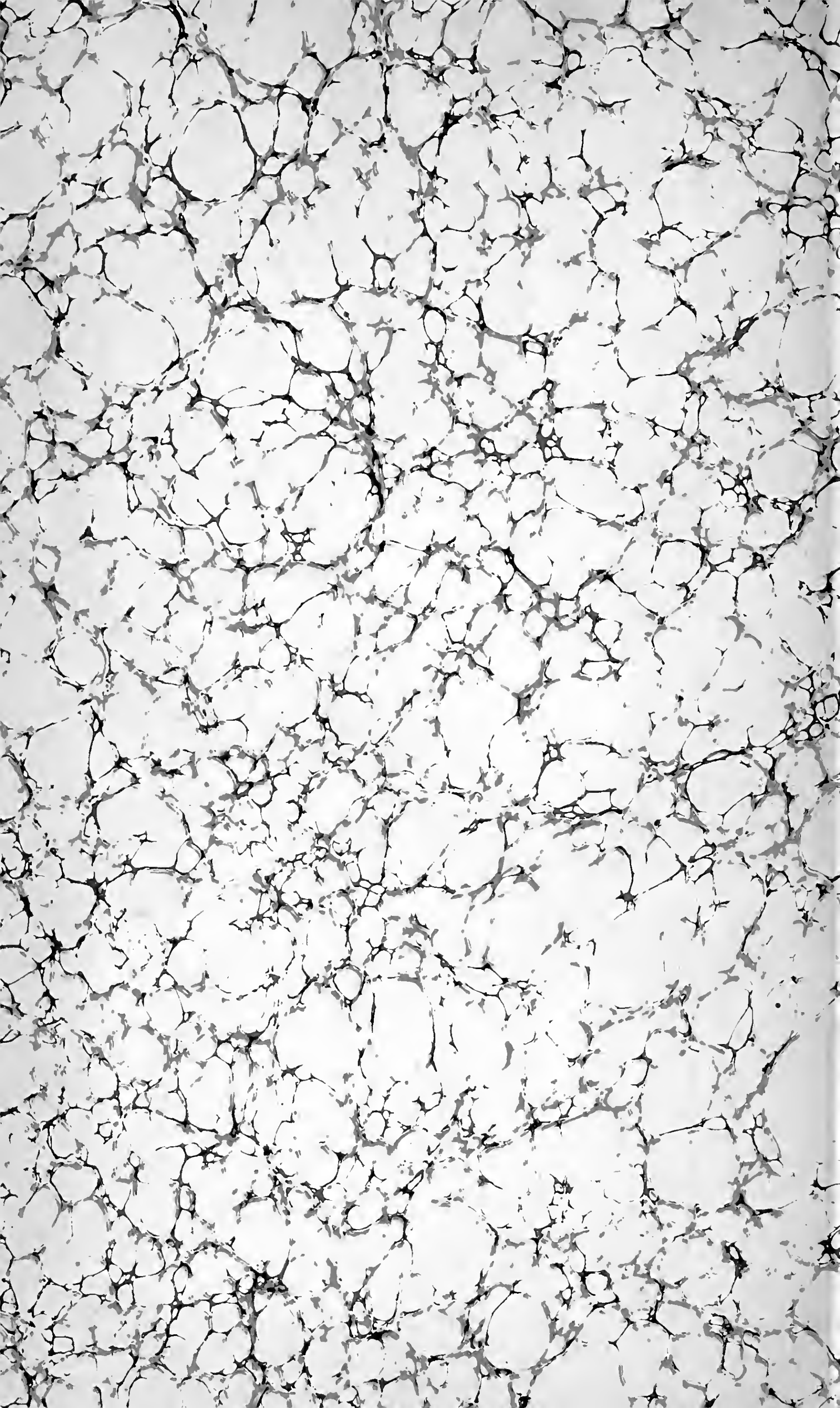

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